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IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

DUQUESNE LIGHT COMPANY, OHIO POWER COMPANY, WEST PENN POWER COMPANY, APPALACHIAN POWER COMPANY, MONONGAHELA POWER COMPANY, THE POTOMAC EDISON COMPANY, and VIRGINIA ELECTRIC AND POWER COMPANY,

Appellants,

v.

STATE TAX DEPARTMENT OF WEST VIRGINIA and MICHAEL E. CARYL, STATE TAX COMMISSIONER OF WEST VIRGINIA,

Appellees,

On Appeal from the Supreme Court of Appeals of West Virginia

BRIEF IN OPPOSITION TO MOTION TO DISMISS OR AFFIRM

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Appellants, Duquesne Light Company, Ohio Power Company, West Penn Power Company, Appalachian Power Company, Monongahela Power Company, The Potomac Edison Company and Virginia Electric and Power Company submit this brief in opposition to Appellees' Motion to Dismiss or Affirm ("Appellees' Motion"). To the extent that Appellees' Motion raises questions that were not addressed in Appellants' Jurisdictional Statement or that require clarification, those questions are

discussed below in the order in which they are presented in Appellees' Motion.[1]

The 1978 Revision of the West Virginia Code

Appellees imply that the 1978 tax changes were made in response to 15 U.S.C. § 391. Appellees' Motion at 3. This implication is not supported by the record. The stipulated record does show that when manufacturers of electricity were removed from the Section 2b manufacturing classification with a tax rate of .88%, and placed in a new Section 2m with a tax rate of 4%, the tax burden to out-of-state consumers increased in 1979 by over thirty million dollars, while the decrease of the Section 2d tax on sales from 4.29% and 5.72% to 4% resulted in a decrease of over five million dollars in the tax burden of West Virginia consumers the same year. See Stipulation Exhibit No. 31. The shifting of tax burden to out-of-state consumers of electricity as a result of the legislation is clear.

The court below held that ". . . Section 2m relates only to in-state generation or manufacture which is transmitted out of state." J.S. App. 37a. Appellees argue in their Motion at page 3, note 3, that this is an "erroneous characterization," and theorize that Section 2m reaches all electricity generated in West Virginia for sale in "unregulated transactions," citing *United Fuel Gas Co. v. Battle*, 153 W.Va. 222, 233-242, 167 S.E.2d 890, 898-902 (W.Va.), appeal dismissed and *cert. denied sub nom. United Fuel Gas Co. v. Haden*, 396 U.S. 116 (1969). In that case the West Virginia Supreme Court held, contrary to Appellees' suggestion, that certain *unregulated* sales to large industrial customers were taxable under Section 2d as a part of the utility's business. Appellees' arguments with respect to regulated transactions

[1] Appellants state pursuant to Rule 28.1 that the Designation of Corporate Relationships appearing in Appellants' Jurisdiction Statement at pages ii through iv is currently accurate, except that

or unregulated transactions appearing throughout the Motion are simply an attempt to avoid accepting the description of the Section 2m tax by the court below as a tax on ". . . the production of electric power in West Virginia when that power is exported to other states. . . ." J.S. App. 6a. Furthermore, Appellees ignore the stipulated record which establishes that the burden of the Section 2m tax falls almost exclusively upon out-of-state consumers. See Stipulation at 220-224.

Section 2m and Section 2d Are Not Complementary or Identical Taxes

The premise which underlies the Appellees' Motion to Dismiss or Affirm is that "[n]otwithstanding the formal structure of the 1978 Act, which gives the appearance of imposing two separate taxes under two separate code sections, the Act actually imposes a unitary tax on the generation of electricity within the state for sale." Appellees' Motion at 4. Appellees' position rests entirely upon the erroneous and unsupportable assertion that Section 2m and Section 2d "levy not merely on substantially equivalent events but on precisely the same event—the generation of electricity within the state." Appellees' Motion at 17.

Section 2m is a tax on those engaged in the business of "generating or producing electric power." Section 2d is a tax on those engaged in a "public service or utility business." Appellees' effort to convert the Section 2d tax into a tax on the generation of electricity is contrary to the statutory language of Section 2d which expressly states that "The measure of the tax under this section shall include only gross income from the supplying of public services. The gross income of the tax-

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the disclosure with respect to Appellant Virginia Electric and Power Company should be amended to include Dominion Financing, Inc. as an affiliate and to reflect a change of name of its affiliate Dominion Exploration, Inc. to Dominion Energy, Inc.

payer from any other activity shall be included in the measure of the tax imposed upon the appropriate section or sections of this article."

A gas utility which produces natural gas pays tax under the Section 2a production classification, and also pays tax under the Section 2d utility classification when it sells the same gas in its utility business, demonstrating that Section 2a and Section 2d are neither compensating nor identical taxes. *See* W. Va. Code, §§ 11-13-2, 2a, and 2d. If it were not for the specific statutory exclusion in Section 2m, a West Virginia electric utility's manufacturing activities would be taxed under Section 2m, and its sales activities under Section 2d, including the sale of electricity manufactured by it.

The West Virginia Supreme Court has held in a series of cases that a single taxpayer is liable for West Virginia business and occupation tax under various sections of the law as a result of engaging in different business activities. *See Virginia Electric and Power Co. v. Haden*, 157 W.Va. 298, 200 S.E.2d 848, *cert. denied*, 416 U.S. 916 (1974), taxed as a manufacturer and a utility; *United Fuel Gas Co. v. Battle*, 153 W.Va. 222, 167 S.E.2d 890, appeal dismissed and *cert. denied sub nom. United Fuel Gas Co. v. Haden*, 396 U.S. 116 (1969), taxed as a producer, a wholesaler, and a utility; *Owens-Illinois Glass Co. v. Battle*, 151 W.Va. 655, 154 S.E.2d 854 (1967) taxed as a producer and a manufacturer; *J. D. Moore, Inc. v. Hardesty*, 147 W.Va. 611, 129 S.E.2d 722 (1963) taxed as a retailer, wholesaler, and servicer. Any contention that the Section 2m tax and the Section 2d tax are complementary taxes, or more absurdly, identical taxes, is contrary to these precedents.

A tax on the business activity of manufacturing and a tax on the business activity of selling are not complementary taxes. *See* Hellerstein, *Complementary Taxes as a Defense to Unconstitutional State Tax Discrimina-*

tion, 39 Tax Lawyer 405 (1986). Hellerstein recognizes that the West Virginia business and occupation tax is imposed upon the privilege of engaging in different business activities or transactions; and, that the complementary tax doctrine, and the "sales and use" tax authorities, have no application to the West Virginia business and occupation tax.

Following this Court's decision in *Armco v. Hardesty*, 467 U.S. 638 (1984), the West Virginia Legislature amended the law to remove the exemption of West Virginia manufacturers from the Section 2c wholesale tax. Although West Virginia Section 2b manufacturers selling at retail were liable for both the Section 2b manufacturing tax and the Section 2c retrial tax prior to *Armco*, the amendment of the law after *Armco* removed the wholesale tax exemption, making manufacturers liable for both the Section 2b manufacturing tax and the Section 2c wholesale tax. This clearly establishes that under the West Virginia business and occupation tax, the tax on the business privilege of selling is not a complementary tax for the business privilege of manufacturing; otherwise, both taxes would not be payable.

Section 2m Violates 15 U.S.C. § 391

Appellees argue that Section 2m does not violate 15 U.S.C. § 391, as applied by this Court in *Arizona Public Service Co. v. Snead*, 441 U.S. 141 (1979), because (a) there is no facial discrimination, and (b) the Section 2d tax is a tax "on or with respect to the generation or transmission of electricity." Appellees are wrong on both points. The statutory exclusion in Section 2m "when the sale thereof is not subject to tax under section two-d of this article" is direct facial discrimination, and refutes any contention that the Section 2m tax is an evenhanded tax on all generation. The Section 2d tax is a tax on the privilege of engaging in the public service business, and the taxable event is the sale of

that service to the consumer, not the generation or transmission of electricity. The Section 2d tax, measured by gross receipts from sales, is the same as the New Mexico gross receipts tax on sales which this Court refused to consider as complementary to the New Mexico generation tax. New Mexico's discrimination was indirect since all generators paid the tax, subject to a credit, while West Virginia's discrimination is direct since all generators do not pay the tax. *See* Lathrop, *"Armco—A Narrow and Puzzling Test for Discriminatory State Taxes Under the Commerce Clause,"* 63 Taxes 551, 560 n. 102 (August 1985).

West Virginia Tax Scheme Fails the Armco "Mirror Image" Test

The complete lack of merit in Appellees' Motion is clearly revealed by Appellees' failure to embrace or support the rationale of the court below that the West Virginia taxing scheme meets the "mirror image" test of *Armco*. The court below undertook to judicially reconstruct the statute when it suggested in its opinion, ". . . Section 2d has a proviso that reduces the electric utility tax from 4 percent to 3 percent on sales and demand charges for domestic purposes when the electricity is produced out of state and then imported into West Virginia." J.S. App. 12a. In fact, there is no such proviso in Section 2d. This "mirror image" analysis was developed by the court below on its own initiative, was not suggested by Appellants, and was never asserted by Appellees during the course of this litigation. It is not defended by Appellees in their Motion, and is clearly wrong. Appellees, on page 20 of the Motion, have misstated Appellants' position with respect to the mirror image test (See J.S. 16), and have merely referred to, or quoted from, the opinion of the court below to justify that court's erroneous conclusion.

In footnote 8 on page 17 of the Motion, which is repeated again on page 19, Appellees contend that Appel-

lants' incorrectly asserted in the Jurisdictional Statement that the 4% rate in Section 2d applies to all sales of electricity by a generating company, including sales of electricity it may have purchased from others. Appellants' statement is correct. It is the Appellees who are in error. Under the express terms of Section 2d, the lower 3% rate applies only to "electric light and power companies which engage in the supplying of public service but which do not generate or produce electric power." If an electric company engages in the public service business and generates any power, the gross income of the public service business is subject to the 4% tax. The Section 2d tax is not "triggered," as Appellees assert on page 19, by the generation of electricity. The tax is imposed on the business privilege of supplying public services, is triggered by the sale of the service, and is measured by the gross income derived from the sales.

In the 1984 decision of the court below which held that the Section 2m tax did not violate 15 U.S.C. § 391, Justice Neely originally noted a dissent, which he subsequently changed to a concurrence. In his concurring opinion, Justice Neely adopted the rationale of the majority that the Section 2d tax was a complementary tax upon the manufacture of electricity for sale in West Virginia, and asserted that 90.8% of the value of electrical energy at the point of consumption is attributable to the cost of manufacture.

Speaking for the unanimous court in its 1986 opinion, Justice Neely attempts to justify the West Virginia tax scheme under the Commerce Clause and the *Armco* "mirror image" test by erroneously asserting that the rate differential in Section 2d of 4% for electric utilities that engage in the supplying of public services, and 3% for electric utilities engaged in the supplying public services but which do not generate or produce electric power, is a credit mechanism for electric power generated outside of West Virginia and sold within the

state. In a footnote to that opinion, Justice Neely erroneously hypothesizes that if the cost of manufacturing electricity is 25% of the cost of electricity at the point of sale, the 1% differential in Section 2d results in the same tax burden on electricity generated outside of the state and sold within West Virginia. Nowhere in Section 2d is the 1% lower rate for nongenerating utilities referred to as a credit mechanism for electricity generated outside of West Virginia and sold within the state. Indeed, the lower rate is available for nongenerating electric utilities which purchase electricity generated within West Virginia for sale in West Virginia.

In footnote 4 of its opinion, the court below conceded: "In *Armco*, the manufacturing tax was not a compensatory tax for the wholesale tax because the manufacturing tax contained no demonstrable sales tax component. . . ." The court below then erroneously concludes that Section 2d does contain a demonstrable manufacturing (Section 2m) component because the tax is imposed on final sales charges which reflect not only the costs of transmission and distribution, but also those of manufacture. Precisely the same justification can be made with respect to the manufacturing tax and the wholesale tax in *Armco* since the Section 2b manufacturing tax is measured by "the gross proceeds derived from the sale thereof by the manufacturer," which measure necessarily includes not only the costs of manufacture, but also the cost of selling. In fact, there is no "demonstrable" manufacturing (Section 2m) component in the Section 2d tax, precisely the same as there was no demonstrable sales tax component in the manufacturing tax in *Armco*. This Court in *Armco* said: "Manufacturing frequently entails selling in the State, but we cannot say which portion of the manufacturing tax is attributable to manufacturing, and which portion to sales." 467 U.S. 643.

Unless *Snead, Armco,* and *Metropolitan* are reversed or modified by this Court, this case merits summary reversal, rather than dismissal or affirmance under Appellees' Motion. The Circuit Court of Kanawha County, West Virginia, was right in 1983 when it declared the Section 2m tax invalid because it violated 15 U.S.C. § 391, citing *Snead* and Note, *West Virginia Generation of Electricity Tax: Is It Valid After Snead,* 83 W.Va. L. Rev. 79 (1981).

CONCLUSION

For the foregoing reasons, Appellees' Motion to Dismiss or Affirm should be denied, and this Court should note probable jurisdiction and grant plenary consideration of this appeal.

Dated: April, 1987

Respectfully submitted,

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